

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 16056
[Redacted])	
)	DECISION
Petitioner.)	
_____)	

On September 27, 2001, the Tax Discovery Bureau (TDB) of the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination to [Redacted] (petitioner), proposing additional income tax, penalty, and interest for the taxable years 1996, 1997, 1998, and 1999 in the total amount of \$27,773. The petitioner filed a timely protest and petition for redetermination. An informal conference was held on March 15, 2002. The Tax Commission, having reviewed the file, hereby issues its decision.

This is a nonfiler case. The petitioner has not filed Idaho S corporate income tax returns for the 1996 through 1999 taxable years. The petitioner argues that it makes no sales in Idaho, receives no income in Idaho, and makes no shipments or deliveries of merchandise to any entity in Idaho and is therefore not required to file an Idaho income tax return and is not liable for the tax and penalty sought by the Tax Commission. The Tax Commission disagrees and finds that the petitioner is not exempt from Idaho's state income tax, is required to file, and has not met its burden of showing that the amount of tax in the Notice of Deficiency Determination is erroneous.

FACTS

The petitioner is a food broker that conducts its business activities through sales personnel and merchandisers.¹ In its amended questionnaire, the petitioner contends that it

¹ See petitioner's responses to questions 8 and 13 on the original questionnaire signed and dated by the company president on March 15, 2001.

conducts its business activities through sales personnel and merchandisers only within [Redacted]. The petitioner has an employee who is domiciled in Idaho; this employee has received a W-2 from the petitioner for each of the years at issue reflecting Idaho wages. The TDB argues that he is a food broker.² Exactly what this employee does within Idaho has yet to be identified in detail.

In 1999, the petitioner reported two additional employees with Idaho wages who, as it turns out, are the children of the other employee. According to the petitioner, the children were hired for that year only to do some work that needed done in order to impress upon the children the value of work, the value of money, and to help the children earn money for their own needs. Although the petitioner has attempted to portray the situation as one where the employee hired his children to do the work, it was the petitioner that paid the children and issued to them a W-2. The petitioner paid each of the children \$4,100 for performing a variety of duties within and without Idaho such as setting up [Redacted] It is not clear if any of the other corporate employees perform any business activities within Idaho.

The TDB believes that employees located in Idaho would perform salesman or merchandiser activities.³ On the other hand, the petitioner argues that its employee domiciled in Idaho does not engage in salesman or merchandiser activities within Idaho as those types of activities are only done by employees in [Redacted] that are dealing with the smaller [Redacted] grocery stores. The petitioner maintains that its employee living in Idaho simply arranges for the representatives of the manufacturers that the petitioner represents to meet with key employees of a large chain of stores that is headquartered in Idaho. The petitioner provided the Tax

² See Page 2, Explanation of Items, attached to and made part of Notice of Deficiency Determination dated September 21, 2001.

³ See TDB Memo dated November 2, 2001, page 2, paragraph 2.

Commission with a copy of the employee's job description; a list of the manufacturers that the petitioner represented or represents; a list of the Idaho-based chain's employees and manufacturer representatives with whom the employee has met; a list of dates, times, locations, and attendees of meetings during 1998 and 1999; and examples of brokerage contracts between petitioner and selected manufacturers. Some of the manufacturers for which the petitioner acts as a broker are located in Idaho.

According to the employee's job description, the employee is a representative for the petitioner and for the companies for which the petitioner acts as a broker. The employee is to set appointments for manufacturer representatives and for himself, present programs on behalf of the manufacturers, present products, and grow the petitioner's profits. The employee's essential duties and responsibilities include travel to eight different states, including Idaho, in order to introduce manufacturer representatives to the appropriate personnel of the Idaho-based chain of stores. The employee is to travel, entertain, and promote good will at a reasonable expense to the petitioner. The employee is to present programs and training, and create good public relations that will generate profits for the petitioner.

According to the documents submitted by the petitioner, the petitioner did not know what duties its employee was actually performing within Idaho on a daily or weekly basis in 1998 or 1999. But the petitioner was able to identify the various meetings that its employee attended at locations within and without Idaho. The employee attended several meetings at locations within Idaho with employees of the Idaho-based chain and representatives of the companies for which the petitioner acts as a broker. The employee also took part in motivational training seminars, career advancement programs of the Idaho-based chain, cooking schools, and a large public festival, all at locations within Idaho. Although the information provided was for taxable years

1998 or 1999, the petitioner has not argued that the employee did not engage in any similar activities within Idaho in taxable years 1996 or 1997.

On February 27, 2001, the TDB sent petitioner a letter stating that the Tax Commission was reviewing the petitioner's activities within Idaho. The petitioner was asked to complete a Business Activity Questionnaire and return the completed questionnaire to the Tax Commission by March 27, 2001. On March 29, 2001, TDB received a completed questionnaire from the petitioner. The questionnaire was signed and dated by the petitioner's president.

After reviewing the petitioner's responses to the questionnaire, the TDB sent the petitioner a letter informing the petitioner that "the services provided by your employees in the state of Idaho are sufficient to give your company nexus in Idaho. As a result, Idaho law requires that you file income tax returns for the years 1996 through 1999." The petitioner did not file the Idaho income tax returns as requested by the TDB. On September 27, 2001, the TDB issued a Notice of Deficiency Determination for taxable years 1996, 1997, 1998, and 1999. The calculation of petitioner's Idaho taxable income contained in the Notice of Deficiency Determination was based upon information provided by the petitioner [Redacted] On October 12, 2001, the petitioner, through its representative, filed a petition for redetermination. In its petition for redetermination, the petitioner argues that, the "questionnaire originally filed was in error, due to a misunderstanding on the part of the filing officer." The petitioner in its petition for redetermination stated that it had filed an amended questionnaire. In October of 2001, the Tax Commission received the petitioner's amended Business Activity Questionnaire signed by the petitioner's president, the same corporate officer who had signed the original questionnaire.

ISSUES

There are three issues for decision. First, whether or not the petitioner is subject to Idaho's state income tax under the Idaho statutes. Second, did federal law, during the years at issue, prohibit the state from taxing the petitioner? Third, if the petitioner was subject to Idaho taxation and not exempt under federal law, has the petitioner met its burden of showing that the calculation of petitioner's Idaho taxable income as shown in the Notice of Deficiency Determination was erroneous?

LAW AND ANALYSIS

Idaho Statutes

For taxable years 1996 through 1999, Idaho Code § 63-3030(a)(4) establishes the Idaho income tax filing requirement for a corporation that is reporting to the federal government as an S corporation pursuant to Internal Revenue Code §§ 1361 through 1379. Section 63-3030(a)(4) provides that an Idaho income tax return is required for an S corporation if it is "transacting business in this state, authorized to transact business in this state or ... has one (1) or more shareholder who is a resident of this state."

An S corporation is transacting business in Idaho if it is "engaging in or the transacting of any activity in this state, for the purpose of or resulting in economic or pecuniary gain or profit," or otherwise meets the definition of "transacting business" set out in Idaho Code § 63-3023. An S corporation is authorized to transact business in Idaho if it is incorporated under the laws of the state of Idaho or if it is a foreign corporation that is required to obtain, or has obtained, a certificate of authority to transact business from the Secretary of State pursuant to Idaho Code § 30-1-1501.

An S corporation has income attributable to Idaho (and therefore must file an Idaho return) if it has any Idaho taxable income that is either apportioned to this state, or allocated to this state, under Idaho Code §§ 63-3027 or 63-3027A.

Based upon the information provided, it is the Tax Commission's finding that the petitioner, through its employee based in Idaho, is engaging in activities in this state "for the purpose of or resulting in economic or pecuniary gain or profit." This constitutes transacting business as defined in Idaho Code § 63-3023. The petitioner is subject to Idaho's state income tax under Idaho law.

Constitutional limitations

Constitutional limitations are found in the Due Process and Commerce Clauses of the U.S. Constitution. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Requisite contacts or "nexus" exists, sufficient to support taxability under the Due Process Clause, if a commercial actor's efforts are purposefully directed toward residents of the taxing state. Under the Commerce Clause as to income taxes, the U.S. Supreme Court might hold that a taxpayer must go beyond the Due Process threshold of "nexus" with the taxing state in order to be taxable. If there is such a requirement, it would be satisfied by having a physical presence in the state, and also possibly by a lesser degree of contact. *Cf. Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)(use tax collection case). The petitioner here has physical presence in Idaho through its employee. Therefore, the Constitution does not bar Idaho from taxing the petitioner.

Federal Public Law 86-272

In addition, under the Constitution, federal statutes are the supreme law of the land. Congress in 1959 enacted Public Law 86-272, 15 U.S.C. § 381, which provides in pertinent part as follows:

(a) No State ... shall have power to impose ... a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; ...

The manufacturers whom the petitioner represents are sellers of tangible personal property (food). The petitioner does not sell food. Rather, it is a food broker that receives its compensation by providing a service. The protection afforded by Public Law 86-272 is not applicable to service providers such as the petitioner. *See* Decision in Docket No. 14443 (2000)(published online at www2.state.id.us/tax/pdf/income/2000/0014443.pdf).

Two decisions in sister states have reached an opposite conclusion. *Schering-Plough Healthcare v. Commonwealth*, 805 A.2d 1284 (Pa. Commw. 2002) and *E. F. Timme & Son, Inc.*, 69-SBE-01, 1969 WL 1795 (Cal. Bd. Eq. 1969). The Tax Commission believes these cases were wrong in holding that the protections of P.L. 86-272 are available to a solicitor of sales who owns no goods.

Amount of tax liability in Notice of Deficiency Determination

The next issue is the calculation of petitioner's Idaho income tax liability. None of the petitioner's shareholders are Idaho residents, and the shareholders have not reported any of the petitioner's income to Idaho as Idaho source income.

The TDB relied upon information provided by the petitioner as well as information obtained from the Internal Revenue Service to determine the amount of Idaho tax due as shown in the Notice of Deficiency Determination. The petitioner has not produced evidence to contradict the TDB's calculation of the Idaho tax liability after being given numerous opportunities to do so. The Tax Commission therefore affirms the amount of Idaho taxable income shown in the Notice of Deficiency Determination. *See Parsons v. Idaho State Tax Commission*, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986) (State Tax Commission's deficiency notice is presumed to be correct and the burden is on the taxpayer to show that the deficiency is erroneous).

The penalty under Idaho Code § 63-3046(c) for failure to file a return is affirmed.

CONCLUSION

WHEREFORE, the Notice of Deficiency Determination dated September 27, 2001, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1996	\$ 2,201	\$ 550	\$ 1,013	\$ 3,764
1997	15,240	3,810	5,693	24,743
1998	174	44	52	270
1999	430	108	95	<u>633</u>
TOTAL DUE				<u>\$29,410</u>

Interest is calculated through May 1, 2003, and will continue to accrue at the rate set forth in Idaho Code section 63-3045. The daily accrual amount is \$2.47 per day.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner's rights to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2003.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2003, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]
[Redacted]

[Redacted]